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UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF CALIFORNIA
SACRAMENTO DIVISION

In re:

CASE NO. 15-29890-D-11

GRAIL SEMICONDUCTOR, a
California corporation,

Date: January 27, 2016
Time: 10:00 a.m.
Courtroom: 34
501 I Street, 6th Floor
Sacramento, CA

DEBTOR'S INITIAL STATUS REPORT

Grail Semiconductor, a California corporation, the Debtor and Debtor in Possession herein (the “Debtor” or “Grail”), files this initial status report pursuant to this Court’s order dated January 4, 2016.

BACKGROUND OF THE DEBTOR AND REASON FOR FILING

The corporate Debtor was organized under the laws of the State of California on January 24, 2000, under the name of NV Memory, Inc., by two cousins, Donald Stern and Robert Stern, as a start-up corporation to market new technology in memory chip design created and patented by Donald Stern. On or about March 1, 2001, the Debtor filed Amended Articles of Incorporation to formally change its name to Grail Semiconductor. The Debtor recently settled “bet the company” litigation resulting in Grail receiving certain settlement proceeds.¹ Certain

¹ The settlement agreement prohibits the disclosure of any of the settlement terms, so Grail is not disclosing specific information about the settlement at this time.

1 payments have been made from these settlement proceeds. The Debtor's primary assets include
 2 the remaining settlement proceeds in the form of cash, an investment in a Canadian mining
 3 company's common stock, and potential claims against former insiders and third parties.

4 Prior to the settlement, Grail had been litigating with Mitsubishi Electric & Electronics
 5 USA, Inc. ("Mitsubishi") for eight years over a breach of a nondisclosure agreement ("NDA")
 6 which was entered into in April 2001. In June 2004, Donald Stern read about new chip
 7 technology from a joint venture between Mitsubishi's parent company, Mitsubishi Electric
 8 Company, and Hitachi, Ltd. Donald Stern believed the joint venture was using the chip
 9 technology in violation of the NDA. In June 2007, Grail sued Mitsubishi in California state court
 10 for, among other things, breach of the NDA.

11 In May 2012, Grail obtained a \$124 million damages award after a three-week jury trial.
 12 That award was set aside when the trial court denied Mitsubishi's motion for a judgment
 13 notwithstanding the verdict, but granted the motion for a new trial as to damages only. The
 14 parties filed cross-appeals. In April 2014, the California Court of Appeal affirmed the trial court
 15 in a published decision. *See generally Grail Semiconductor, Inc. v. Mitsubishi Electric &*
16 Electronics USA, Inc., 225 Cal. App. 4th 786, 789 (2014).

17 Shortly after the settlement with Mitsubishi, Grail's then-CEO took a number of actions
 18 adverse to Grail's interests, including seeking to void Grail's fee agreement with its attorneys
 19 without the approval of Grail's Board of Directors ("Board").² In late October 2015, the Board
 20 revoked the corporate authority of Grail's only two officers ("Officers"), Ron Hofer and Brad
 21 Woods.

22 Based on demands against the settlement proceeds, it became clear that creditor claims
 23 likely could exceed the settlement proceeds. In November 2015, the Board retained counsel to
 24 assist it in evaluating its current state of affairs, including claims against its assets. In mid-
 25 December 2015, the Board also retained Michael F. Burkart as Grail's CRO to lead Grail's efforts
 26 to pursue claims held by Grail as well as resolve all claims against the company.

27
 28 ² Grail's current Board of Directors consists of Retired Superior Court Judge Richard L. Gilbert,
 Donald Stern and Robert Stern.

1 Facing the threat that an involuntary petition would be filed and of numerous demands
 2 from creditors and shareholders for payment, the Debtor filed this Chapter 11 case on December
 3 30, 2015. The timing was primarily driven by the need to preserve possible avoidance actions.

4 **POST-PETITION ACTIVITIES**

5 On December 30, 2015, the Debtor filed and served a motion to employ Mr. Burkart as
 6 the Debtor's CRO post-petition ("Motion"). The Motion is set for hearing on January 27, 2016,
 7 at 10:00 a.m., the same time as the initial status conference in this case. Written opposition to the
 8 Motion was to be filed no later than January 13, 2016. As outlined in the Motion, Mr. Burkart
 9 has the experience and skill set to lead the Debtor in evaluating its potential litigation claims,
 10 resolving claims against and interests in the Debtor, and evaluating the Debtor's future business
 11 prospects.³

12 Because the authority of the Debtor's CEO and CFO was revoked, the Debtor is in the
 13 unusual position of not having all of the information about its operations over the past several
 14 years. Mr. Burkart and counsel for the Debtor have invested substantial amounts of time, both
 15 pre-petition and post-petition, to gather and absorb as much information as possible. However, as
 16 discussed below, that process continues.

17 On January 4, 2016, the Debtor applied for and obtained an extension to January 28, 2016,
 18 to file its schedules and related documents. On December 31, 2015, and January 4, 2016, the
 19 Debtor sent letters to the Officers requesting turnover of the Debtor's corporate records and other
 20 information necessary for the Debtor to complete its schedules and related documents by
 21 January 11, 2016, so the Debtor could comply with the January 28, 2016 deadline.

22 The Debtor has been receiving the requested information on a rolling basis. The Debtor
 23 will make every effort to have those schedules completed and ready to be filed by January 28,
 24 2016. However, to ensure that the Debtor has adequate time to collect the necessary information
 25 and complete its schedules timely, the Debtor requested an additional 14 days beyond the current
 26 deadline of January 28, 2016 (to February 11, 2016) to prepare and file its Schedules, Statement

27 ³ The U.S. Trustee filed a pleading outlining certain provisions it would like to see in any order
 28 granting the Motion. The Debtor believes it will be able to work out an agreed order to satisfy the
 U.S. Trustee's concerns.

1 of Financial Affairs and List of Equity Security Holders in the appropriate format. The Debtor's
 2 second motion to extend the time to file schedules was filed on January 13, 2016, and is set for
 3 hearing at the same time as this status conference.

4 The settlement agreement with Mitsubishi includes a provision generally prohibiting the
 5 Debtor from disclosing the settlement terms, including but not limited to the amount of the
 6 settlement. Recognizing that the settlement terms will have to be disclosed in the bankruptcy
 7 case, the Debtor has sent a letter to Mitsubishi in accordance with the settlement agreement
 8 informing Mitsubishi that Grail is compelled by law to disclose the settlement terms, thereby
 9 placing the burden on Mitsubishi to seek a protective order if it so chooses.

10 **FILING OF A PLAN**

11 Until the Debtor receives all of its books and records and completes its investigation of its
 12 assets, claims and potential business prospects, it is difficult to predict the type of plan or the
 13 timing of a plan. Certainly, it is unlikely the Debtor will file a plan prior to the claims bar date of
 14 June 27, 2016, for governmental claims.

15 **CRAMDOWN**

16 At this time, the Debtor anticipates proposing a liquidating plan of reorganization that will
 17 be confirmed under 11 U.S.C. § 1129(a)(8) and will not require cramdown pursuant to 11 U.S.C.
 18 § 1129(b).

19 **VALUATION OF ASSETS**

20 The Debtor does not anticipate any litigation concerning the valuation of assets. The
 21 Debtor anticipates litigation over whether certain pre-petition transfers are avoidable and in
 22 connection with objections to claims.

23 **CASH COLLATERAL AND ADEQUATE PROTECTION**

24 While certain creditors assert a security interest in the remaining settlement proceeds, the
 25 Debtor does not anticipate any motions concerning cash collateral at this time. The Debtor does
 26 not anticipate any contested motions concerning adequate protection issues.

27 **ENVIRONMENTAL ISSUES**

28 The Debtor is not aware of any material environmental issues relating to its property or

1 operations.

2 **OBJECTIONS TO CLAIMS**

3 The claims bar date has not yet passed in this case. The Debtor will object to any claims
4 that are materially inaccurate. It is too soon to determine the number of objections to claims or
5 the dollar amount of the objections the Debtor will file.

6 **POST-CONFIRMATION SALE OF ASSETS**

7 The Debtor holds certain shares of stock plus warrants in Nemaska Lithium, Inc., a
8 Canadian mining company, that may be sold during this Chapter 11 case.

9 **ANTICIPATED PROFESSIONAL FEES**

10 At this early juncture in the case, it is not possible to project the total professional fees in
11 this case. To date the Debtor has requested, and obtained, Court authority to employ Felderstein
12 Fitzgerald Willoughby & Pascuzzi LLP as its Chapter 11 counsel.

13 The Debtor also may file applications to employ the Law Offices of Timothy A. Charshaf
14 as its special corporate counsel, as Mr. Charshaf has been general corporate counsel for Grail pre-
15 petition and has extensive knowledge about Grail. The Debtor also will file an application to
16 employ certified accounting professionals to assist with the preparation and filing of reports with
17 the appropriate taxing authorities. Further, the Debtor is evaluating whether the employment of
18 Boutin Jones, Inc. is needed. Boutin acted as Grail's special litigation counsel with respect to
19 ongoing litigation with one of the prior officers, Ronald Hofer.

20 Dated: January 15, 2016

21 **FELDERSTEIN FITZGERALD
WILLOUGHBY & PASCUZZI LLP**

22 By:/s/ Paul J. Pascuzzi
23 PAUL J. PASCUZZI
24 Attorneys for Grail Semiconductor

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